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Nos. 86-71, 86-97



IN THE

# Supreme Court of the United States

October Term, 1986

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CTS CORPORATION,
*Appellant,*
v.
DYNAMICS CORPORATION OF AMERICA,
*Appellee.*

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STATE OF INDIANA,
*Appellant,*
v.
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ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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# JOINT BRIEF OF THE INDIANA CHAMBER OF COMMERCE AND INDIANA LEGAL FOUNDATION, INC. AS *AMICI CURIAE* IN SUPPORT OF APPELLANTS CTS CORPORATION AND THE STATE OF INDIANA

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**JOINT BRIEF OF THE INDIANA CHAMBER OF COMMERCE AND INDIANA LEGAL FOUNDATION, INC. AS *AMICI CURIAE* IN SUPPORT OF APPELLANTS CTS CORPORATION AND THE STATE OF INDIANA**

The Indiana Chamber of Commerce and Indiana Legal Foundation, Inc. respectfully submit this joint brief as *amici curiae* in support of Appellants CTS Corporation and the State of Indiana, with the consent of the parties, to urge the Court to reverse that part of a decision by the United States Court of Appeals for the Seventh Circuit which held that portions of the Indiana Business Corporation Law were unconstitutional under the Supremacy Clause and the Commerce Clause.

## STATEMENT OF INTEREST

The Indiana Chamber of Commerce ("Indiana Chamber") is the largest association of businesses in Indiana, having more than 4,500 business firms as members. A very large percentage of these members are firms organized and doing business as corporations under the laws of Indiana. Some are corporations publicly traded on securities exchanges, others are not traded on exchanges but have enough shareholders to be subject to the statutory provisions at issue in this case, and still others are closely-held corporations. Indiana Legal Foundation, Inc. ("Foundation") is a private, not-for-profit corporation that represents a group of business and industrial concerns from across the State of Indiana in litigation involving broad and significant legal questions.

The Indiana Chamber and the Foundation are concerned about this case because they believe the State of Indiana should have a general corporation statute that has as one of its primary goals the fair treatment of corporate shareholders *as a whole* and that allows members of corporate management to pursue the type of business strategy that they, as the *elected* representatives of the shareholders, deem to be in the best overall and long-range interests of the corporation and its shareholders. One of the State's tools for effecting these goals, the Control Share Acquisitions Chapter, Ind. Code Ann. § 23-1-42-1, *et seq.* ("Control Share Chapter"), was effectively declared

unconstitutional on its face by the United States Court of Appeals for the Seventh Circuit. The entire Indiana Business Corporation Law ("IBCL"), of which the Control Share Chapter is but one small part, was prepared in 1985 by the Indiana General Corporation Law Study Commission, and the Indiana Chamber assisted the Commission in the process of developing ideas for and drafting the IBCL in part because the Indiana Chamber's members favored the type of fair and reasonable provisions that are set forth in the Control Share Chapter. Neither the Indiana Chamber nor the Foundation support any unfair treatment of tender offers. In fact, the Indiana Chamber has members who would not want to be precluded from making tender offers for Indiana corporations.

## SUMMARY OF ARGUMENT

The Control Share Chapter does not regulate the purchase and sale of shares in tender offers, which is the subject of the Williams Act. The Control Share Chapter establishes, in effect, a permissive corporate charter provision which governs the voting rights of shares under certain change of control circumstances. The validity of shareholder rights charter provisions is invariably determined on the basis of state law. Attempts by Congress to adopt legislation regulating shareholder rights charter amendments have thus far failed.

As the Control Share Chapter is the functional equivalent of a shareholder rights charter amendment, and as shareholder rights amendments are immune from constitutional attack, the Seventh Circuit's holding has created the anomaly that Indiana is forbidden to automatically include the Control Share Chapter in charters of its domestic corporations (subject to a corporation's right to opt out of the Control Share Chapter), but is free to invite its domestic corporations to adopt the identical provisions *with impunity* on their own. Not only is this result illogical, but it conflicts with the traditional

right of a state to govern the relationships among its corporations and their officers, directors and shareholders. The line should be drawn on preemption by the Williams Act between statutes that regulate the purchase and sale of shares in tender offers and those that do not.

In applying the benefit/burden test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), under the Commerce Clause, the Seventh Circuit adopted its own economic theory to demonstrate conclusively that any putative benefits to legally cognizable Indiana constituencies would be insignificant. The *amici*, on the other hand, believe that there are real and substantial benefits from the Control Share Chapter for Indiana corporations and their shareholders, officers and directors. This disagreement illustrates the dispute among those who have given serious thought to the issues in the tender offer debate. The *amici* believe that in the absence of any evidence of the Control Share Chapter's effect on Indiana constituencies and in the absence of federal legislation, the Court should defer to the policy decision of the State of Indiana, in accordance with the presumption of the constitutionality of state statutes in areas traditionally regulated by the states.

Finally, the *amici* believe that a close examination of the operation of the Control Share Chapter leads to the conclusion that it will not in any way preclude tender offers for Indiana corporations. Several strategies for conducting a tender offer, consistent with the Control Share Chapter, are evident.

## ARGUMENT

The overarching issues before the Court in this case are (a) whether federal law so dominates the tender offer arena that any state action having some effect on tender offers violates the Supremacy Clause of the United States Constitution, even if it is an action traditionally within the exclusive province of the states, and (b) whether the appellate court's benefit/burden analysis under the

Commerce Clause of the United States Constitution, which amounts to a judicially enunciated national policy opposing state statutes that affect tender offers, will be approved. The Control Share Chapter has been labeled by the Seventh Circuit as an anti-takeover statute and a "lethal dose" for takeovers of Indiana corporations by hostile tender offers. Appendix to Jurisdictional Statement of Appellant CTS Corporation ("CTS App.") at A23. Unquestionably, the Control Share Chapter *affects* tender offers under certain circumstances. After all, it may be inferred from the language of the Control Share Chapter and of other shareholder protection provisions of the IBCL that the Control Share Chapter was adopted to correct perceived abuses. However, the Control Share Chapter does not *regulate* tender offers, and the real and substantial benefits the Control Share Chapter provides to Indiana shareholders outweigh any incidental effects it may have on tender offers for the shares of Indiana corporations.

The Indiana Chamber and the Foundation will not repeat in this brief the analyses of CTS Corporation and the State of Indiana demonstrating that the Control Share Chapter does not violate either the Supremacy Clause or the Commerce Clause. The Indiana Chamber and the Foundation will focus instead on three points they believe to be particularly significant in evaluating those analyses. They believe, first, that the Control Share Chapter is in the nature of a shareholder rights charter provision operative only *after* a control share acquisition and, therefore, cannot be preempted by the Williams Act. Secondly, they believe that the Control Share Chapter provides substantial benefits and that, in the absence of federal legislation, the presumption of the constitutionality of state statutes in traditionally state-regulated areas should govern rather than the unsubstantiated economic theory of the Seventh Circuit. And, finally, the Indiana Chamber and the Foundation are convinced that a careful analysis of the Control Share Chapter reveals that its presumed role in

deterring tender offers is materially overstated. This brief is intended to underline, from a public policy perspective, the conclusions that CTS Corporation and the State of Indiana reach following more traditional Supremacy Clause and Commerce Clause analyses.

## I. The Control Share Chapter is in the Nature of a Shareholder Rights Charter Provision and is not Preempted by the Williams Act.

As the operation and effect of the Control Share Chapter are essentially the same as many types of shareholder rights charter provisions and the Control Share Chapter is not concerned with the activities regulated by the Williams Act, it is both illogical and improper to conclude that the Williams Act preempts the Control Share Chapter.

### A. The Control Share Chapter does not Regulate the Purchase and Sale of Shares and, Therefore, is not Preempted by the Williams Act.

The Control Share Chapter does not in any way regulate the buying and selling of shares in a tender offer or otherwise. The Control Share Chapter in effect does nothing more than establish a permissive corporate charter provision which governs the voting rights of shares under certain change of control circumstances. Shares of any public Indiana corporation subject to the IBCL are subject to the provisions of the Control Share Chapter, unless the corporation opts out,[1] as part of the share contract. The Control Share Chapter thus defines certain of the rights of shares, and it is the bundle of share rights, the share contract, which is bought and sold in the market.

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[1] The effective date of the IBCL is August 1, 1987. However, before its effective date a corporation may, under Ind. Code Ann. § 23-1-17-3(b), elect to have most of its provisions, including the Control Share Chapter, apply to it. At any time, a corporation may elect under Ind. Code Ann. § 23-1-42-5 not to be governed by the Control Share Chapter.

Generally, the Williams Act regulates the purchase and sale of corporate shares by means of tender offers, not, as the Seventh Circuit stated, the "interstate traffic in corporate control." CTS App. at A24; *see Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 22-24 (1977) (summarizing the Williams Act); *Edgar v. MITE Corp.*, 457 U.S. 624, 632 (1982) (also briefly summarizing the Williams Act). For example, where a battle for corporate control has nothing to do with the buying and selling of shares in a tender offer, such as in a proxy contest or an open-market stock accumulation,[2] the Williams Act is wholly inapplicable.

The Control Share Chapter differs fundamentally from other state statutes which are sometimes denominated "control share acquisition" statutes. The Control Share Chapter affects how control shares are treated *after their purchase* in relation to other shares of the corporation, rather than regulating in any way the purchase or sale of shares in the first instance. This sets the Control Share Chapter apart from the Williams Act and is the heart of the distinction between the area covered by federal tender offer regulation and traditional state corporate law. The governance of tender offers and the governance of internal corporate matters have never been held to intersect. *See Edgar v. MITE Corp.*, 457 U.S. 624, 645-646 (1982) (the "internal affairs doctrine" was of no avail to supporters of an Illinois takeover statute because the statute regulated the buying and selling of shares, not the relationships among or between the corporation and its officers,

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[2] For a discussion of a successful application of this emerging takeover technique, *see* Hertzberg & Rundle, *Campeau's Victory in Battle for Allied Signals Big Changes in Takeover Tactics*, Wall St. J., Nov. 4, 1986, at 2, col. 3.

directors and shareholders).[3] The Control Share Chapter is the functional equivalent of a shareholder rights charter provision governing voting rights, and the adoption of any such provision is an internal corporate matter.

B. **Shareholder Rights Charter Provisions are Regulated Solely by State Law.**

The remarkable increase in tender offers in recent years has led to the development of a wide variety of provisions in corporate charters and by-laws adopted for the purpose of making corporations less attractive takeover candidates and to ensure fair treatment of non-tendering shareholders in the event of a takeover. Winter, Stumpf & Hawkins, *Shark Repellents and Golden Parachutes: A Handbook for the Practitioner*, at 3-5; Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 Harv. L. Rev. 1693, 1744 (1985). Provisions in use today range from staggered terms for members of the board of directors to provisions for the issuance of bargain-price securities to shareholders in the event of a control share acquisition, which are sometimes referred to as "poison pills."[4] *See, generally*, Securities Exchange Act Release No. 15230 (October 13, 1978), [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,748; Wander & LeCoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 Bus. Lawyer 29 (November 1986); Winter, Stumpf & Hawkins, *Shark Repellents*.

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[3] All of the post-*MITE* cases in which takeover statutes have been struck down under the Supremacy Clause have involved statutes that restricted in some way the purchase of shares. None considered the issue of voting rights apart from stock ownership. *Icahn v. Blunt*, 612 F. Supp. 1400 (W.D. Mo. 1985); *APL Limited Partnership v. Van Dusen, Inc.*, 622 F. Supp. 1216 (D. Minn. 1985); *Fleet Aerospace Corp. v. Holderman*, 796 F.2d 135 (6th Cir. 1986).

[4] For consistency, such provisions, whether amendments to or original provisions in corporate charters, articles of incorporation or by-laws, will hereinafter be referred to as "shareholder rights provisions."

The courts have analyzed the legality of these provisions on two levels: First, whether the adoption of the amendment by the board and/or the shareholders was authorized by a state enabling statute (which is typically the state's general corporation statute), or was without statutory authorization and, therefore, illegal or *ultra vires*. Second, whether the board violated its fiduciary duty to the shareholders by adopting an amendment unfair to the shareholders and tending to entrench the incumbent management, or acted in good faith in the best interests of the corporation and its shareholders.

In *Moran v. Household International, Inc.*, Del, 500 A.2d 1346 (1985), the Delaware Supreme Court upheld the adoption of a complicated "poison pill" charter amendment pursuant to which Household's shareholders would receive the right to buy preferred shares in Household or common shares in the corporation surviving a hostile merger with Household at a discounted price in the event of the acquisition or the threatened acquisition of control shares of Household. After concluding that the board had authority to adopt the amendment under the Delaware General Corporation Law and that the provisions giving that authority were not preempted by the Williams Act and did not violate the Commerce Clause, the court held that the board adopted the plan "in the good faith belief that it was necessary to protect Household from coercive acquisition techniques," and not for the purpose of entrenching itself. *Id.* at 1357. Therefore, the board's adoption of the shareholder rights plan did not violate its fiduciary duty to the shareholders.

In *Minstar Acquiring Corp. v. AMF Inc.*, 621 F. Supp. 1252 (S.D.N.Y. 1985), the target corporation's board adopted a number of shareholder rights provisions, including a "poison pill." The court (applying New Jersey law) found that the "poison pill" amounted to a major change in the structure of the corporation's capitalization and in shareholder voting rights and, consequently, could

only be approved with a shareholder vote. *Id.* at 1259. The board's adoption of the "poison pill" without the shareholders' approval was an *ultra vires* act. *Id.* The court also held that the non-transferability of the rights package issued to shareholders after the tender offer trigger was an unreasonable restraint on alienation of property and, therefore, illegal under New Jersey law. *Id.* at 1258.

Although shareholder rights provisions often have the effect of deterring tender offers, their validity is invariably determined on the basis of state law. For reasons which will be discussed *infra*, statutory provisions enabling the adoption of shareholder rights amendments have not been successfully challenged under the Supremacy Clause. Congress has so far been unwilling to enter into the regulation of shareholder rights provisions. For example, recent efforts to nullify the business judgment rule — which promotes adoption of defensive measures by creating the presumption that board actions have been taken in the best interests of the corporation and its shareholders — by federal legislation have failed. *See* ABA Securities Regulation Committee, *Annual Review of Federal Securities Regulation*, 40 Bus. Lawyer 997, 1017 (1985) (discussing H.R. 5695, 98th Cong., 2d Sess. (1984)). Corporate boards today may adopt shareholder rights amendments unrestricted by federal law and, by virtue of the business judgment rule, with a limited amount of protection in most states against being second-guessed by the courts as to their motives.

### C. The Control Share Chapter is Equivalent to a Moderate Shareholder Rights Charter Provision.

The Control Share Chapter shares characteristics with various types of shareholder rights provisions. For example, a Delaware corporation's charter contained a control shares voting provision very similar in effect to the Control Share Chapter in *Providence & Worcester Co. v. Baker*, Del., 378 A.2d 121 (1977). The Delaware Supreme

Court upheld the charter provisions as consistent with the state's general corporation statute.[5] The voting plan in *Providence & Worcester* provided that each common share up to 50 for each shareholder had one vote, and each common share in excess of 50 for each shareholder had one-twentieth of a vote. In addition, no shareholder could vote more than 25% of the total number of voting shares except by proxy. As with the Control Share Chapter, shares had different voting rights depending on which shareholder held them. Plans similar to the charter provisions in *Providence & Worcester* were upheld under Iowa law in *Kersten v. Pioneer Hi-Bred International, Inc.*, 626 F.Supp. 647 (N.D. Iowa 1985), and found to be *ultra vires* under New Jersey law in *Asarco Inc. v. Court*, 611 F. Supp. 468 (D. N.J. 1985). In each case, the plan's validity was determined pursuant to state law, not the Williams Act.

The shareholder rights plan at issue in *Moran v. Household International, Inc.*, Del., 500 A.2d 1346 (1985), provided, among other things, for the issuance of one "right" per common share to pre-acquisition shareholders in the event any single entity or group acquired 20% or more of Household's shares. A "right" was exercisable to purchase a fractional share of preferred stock, or, in the event of a subsequent merger, a "right" could be exercised to purchase \$200 of the common stock of the survivor for \$100. The plan did not prohibit or restrict in any way the purchase of shares by a tender offeror. Both the Control Share Chapter and the shareholder rights plan in *Moran* concern the treatment of shares *after their purchase* in relation to other shares of the corporation. Unlike the shareholder rights plan, however, the Control Share Chapter permits the post-acquisition dilution of voting rights to be reversed by a simple majority of the shareholders.

[5] The lawsuit did not arise in connection with a tender offer. The only issue was whether the charter provisions were authorized by the state statute.

In cases such as these, courts struggle to find the proper balance between the right of shareholders to have unobstructed access to tender offerors and the legitimate concern that not all tender offers are in the best interests of the shareholders as a whole. Indiana endured the same struggle in crafting the Control Share Chapter and resolved it by giving the shareholders the right to determine whether control of the corporation will change.

D. **Eliminating the Control Share Chapter While Permitting Similar Provisions as Charter Amendments is Illogical and not Required by the Williams Act.**

Although the Control Share Chapter and several types of shareholder rights provisions may operate very similarly and produce similar results, the Control Share Chapter is an explicit provision of a state statute, and charter amendments are adopted by boards of directors (sometimes with and sometimes without shareholder approval). The court in *Moran v. Household International, Inc.*, Del., 500 A.2d. 1346, 1353 (1985), rejected the argument that the provisions of the Delaware General Corporation Law authorizing the shareholder rights plan at issue were preempted by the Williams Act. The court held that the action of a board of directors in adopting a shareholder rights amendment is a private action. *Id.* The fact that the adoption took place pursuant to a state statute did not provide a sufficient "nexus" to the state to constitute state action in conflict with the Williams Act. *Id.; see also Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 5 (2d Cir. 1983), *cert. den.*, 465 U.S. 1052 (1984); *Schreiber v. Burlington Northern, Inc.*, 472 U.S. ____, 86 L.Ed.2d 1, 9 (1985) (provisions of the Williams Act not "an invitation to the courts to oversee the substantive fairness of tender offers . . ."). The consequence of these holdings is simply to

immunize shareholder rights provisions from constitutional attack.[6]

Combining the *Moran* decision with the Seventh Circuit's decision in this case creates the anomaly that a shareholder rights provision, no matter how much it operates to discourage or even eliminate the possibility of tender offers, will be judged solely on state law grounds, while the same provision, if effectively included in the corporation's charter by statute, will be judged by its compliance with the Williams Act. Indiana could spell out the terms of the Control Share Chapter in the State's general corporation statute as a charter amendment that boards of directors of Indiana corporations would be *authorized* to adopt, and provide that its adoption would not constitute a breach of the board's fiduciary duty to the shareholders, and the provision would be immune from Supremacy Clause challenge.[7] In that case, the only

[6] The *Moran* court did not decide the question of whether the Williams Act would have preempted the shareholder rights plan at issue if there had been state action connected with its adoption.

[7] It is well established that a state has the right to determine the fiduciary duties of corporate directors, and, consequently, to eliminate them in connection with certain actions. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 479 (1977) (fiduciary standards with respect to corporate transactions vary from state to state and applying a "federal fiduciary principle" would overlap and possibly interfere with state corporate law); *Cort v. Ash*, 422 U.S. 66, 84 (1975) (state fiduciary standards put shareholders on notice of which duties directors of their corporations have and which duties they do not have).

It is probably inaccurate to speak of the duties of corporate directors as "fiduciary duties," as if directors were subject to the same duty of care as trustees. Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 Bus. Lawyer 883, 886-888 (1976). In fact, the duty of care and the duty of loyalty owed by directors to shareholders are simply two of many duties of corporate directors set forth at common law, in state statutes and even in some federal statutes. State general corporation statutes vary considerably in the

*(Footnote continued)*

difference from the Control Share Chapter would be that the board would have the choice to opt in to the provision rather than the choice to opt out. The shareholders would have the same level of protection under either scenario, because the State, the directors, and the shareholders themselves would all be deciding what is in the best interests of the shareholders as a whole.

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*(Footnote continued)*

myriad of duties required of directors and in the standards to which directors are held in performing those duties. It is not unprecedented for a state to relieve directors from liability for actions "traditionally" (*i.e.*, at common law or under a prior general corporation statute) the responsibility of the board of directors. *See, e.g.*, McKinney's N.Y. Bus. Corp. Law § 620(f) (charter provision placing certain board duties in the hands of the shareholders, subject to the consent of all of the shareholders, relieves directors of liability for negligence in the performance of such duties).

The IBCL, a comprehensive corporate statute of which the Control Share Chapter is but one of many integral parts, contains numerous other provisions changing directors' duties and liabilities from those under prior law. For example, the statute provides that directors will not be liable for any action or failure to take action unless the director has breached or failed to perform certain enumerated duties and such breach or failure to perform constitutes *willful misconduct or recklessness* (Ind. Code Ann. § 23-1-35-1(a) and (c)); that directors may, in considering the best interests of a corporation, consider the effects of an action on shareholders, *employees, suppliers and customers of the corporation, and communities in which offices or other facilities are located* (Ind. Code Ann. § 23-1-35-1(d)); that a corporation has much broader powers to indemnify an individual and advance expenses if that individual is made party to a proceeding because the individual is or was a director (Ind. Code Ann. §§ 23-1-37-1 through 15); and that the directors are empowered to establish a corporate committee to determine whether it is in the best interests of the corporation that a proceeding be continued in which the rights of the corporation are asserted derivatively (Ind. Code Ann. §§ 23-1-32-1 through 5). Delaware has also recently modified its general corporation statute to allow shareholders to include in the corporate charter a provision limiting directors' monetary liability for certain types of breaches of fiduciary duty. Del. Gen. Corp. Law § 102(b)(7).

It is difficult to believe that the intent of the Williams Act was to give constitutional significance to the trivial distinction between the way Indiana actually chose to exercise its prerogatives and the way it could have exercised them. The fact that the adoption of the Control Share Chapter is consistent with a state's traditional right to govern the relationships among its corporations and their officers, directors and shareholders makes the anomaly even harder to accept. *See Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 478-479 (1977) ("Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden"); *Cort v. Ash*, 422 U.S. 66, 83-85 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation").

By no means do the *amici* favor all shareholder rights provisions. They do favor the type of provisions contained in the Control Share Chapter, because they are tempered and fair. The question the *amici* pose is whether the Williams Act was ever intended to grow to so dominate the tender offer arena that the traditional right of states to enact such provisions concerning the internal affairs of their domestic corporations would be in peril.

There is no evidence that the Williams Act was intended to prevent a state from effectively inserting into the charters of its corporations a shareholder rights provision that it could just as easily have permitted corporate directors to adopt on their own *with impunity*. The State's action is consistent with the traditional right of states to govern the internal affairs of their domestic corporations and is not inconsistent with the Williams Act's regulation of

buying shares in a tender offer. A line has to be drawn somewhere on the preemptive power of the Williams Act. The Indiana Chamber and the Foundation believe that to be logical and consistent with over 160 years of jurisprudence, from *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819), to the present, the line should be drawn between statutes that regulate the purchase and sale of shares in tender offers and those that do not. Such a rule would be consistent with the text of the Williams Act, its legislative history and its interpretation by this Court. At the same time, it would not imperil the traditional role of the states in governing the internal affairs of their domestic corporations. Under such a rule, there would be no constitutional conflict between the Williams Act and the Control Share Chapter.

## II. The Control Share Chapter Produces Significant Benefits, and any Burdens it Imposes on Interstate Commerce are Negligible.

The heart of the Seventh Circuit's holding that the Control Share Chapter is unenforceable by reason of the Commerce Clause is that the Control Share Chapter impairs the interstate market for corporate control. In its most telling statement, the Seventh Circuit said:

> "Even if a corporation's tangible assets are immovable, the efficiency with which they are employed and the proportions in which the earnings they generate are divided between management and shareholders depends on the market for corporate control — an interstate, indeed international, market that the State of Indiana is not authorized to opt out of, as in effect it has done in this statute." CTS App. at A26.

In the absence of any evidence as to the Control Share Chapter's effect on CTS Corporation and its shareholders, directors, officers and employees, the Seventh Circuit adopted the foregoing theory to prove that shareholders of

large Indiana corporations are unequivocally hurt by the Control Share Chapter. It is worth pointing out that the Seventh Circuit's theory is, in fact, just a theory. The Control Share Chapter provides a number of benefits for Indiana corporations, shareholders, directors, officers and employees, and to the extent the Court is not persuaded, by virtue of the divergent views of the eminent commentators on this point, the presumption that the Control Share Chapter is constitutional should apply. As for the alleged burdens brought about by the Control Share Chapter, the Seventh Circuit materially overstated the degree to which the Control Share Chapter is likely to affect tender offers without any specific analysis of its probable operation in practice.

### A. The Control Share Chapter's Benefits Should not be Determined by the Seventh Circuit's Unsubstantiated Economic Theory.

In analyzing the Control Share Chapter, the Seventh Circuit followed the balancing test set out in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).[8] In applying that test, the Seventh Circuit held that the legally cognizable interest of the State of Indiana — the welfare of Indiana residents — is not furthered by the Control Share Chapter and might even be hindered by it. CTS App. at A25. The Indiana Chamber and the Foundation are compelled to ask how, with no evidentiary record in this case and conflicting authority from the academic experts, the Seventh Circuit could so confidently make this assessment of the putative benefits to Indiana residents. Contrary to the Seventh Circuit, the Indiana Chamber and the Foundation believe that there are real and substantial benefits from the Control Share Chapter which flow to Indiana corporations

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[8] CTS Corporation has taken the position that the Court should not even reach the *Pike* balancing test in holding that the Control Share Chapter does not violate the Commerce Clause. The *amici* agree, but assume, *arguendo*, for purposes of this brief, that the balancing test applies.

and their shareholders, officers and directors. Among those benefits are: First, the Control Share Chapter protects all shareholders by providing for shareholder approval of any change of control proposal, as in other similar corporate transactions. Second, the Control Share Chapter protects the minority shareholders by giving them dissenters' rights in the event a change of control is approved against their wishes. And, third, the Control Share Chapter promotes better corporate governance through the recruitment and retention of quality directors to govern Indiana corporations.[9] These benefits accrue to the advantage of the corporations, their employees, and the communities in which they are located.

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[9] As is apparent from the remainder of the IBCL, the Indiana legislature was concerned with, among other things, protecting the quality of corporate governance in Indiana corporations by granting certain protections to corporate directors. (*See* note 7, *supra*, concerning the provisions of the IBCL dealing with directors' duties and liabilities.) It is well documented that the proliferation of actions against directors and the increased cost (and even unavailability) of director and officer liability insurance have led to a reluctance of individuals to serve as directors of publicly held corporations. *See, generally*, Bishop, *Law of Corporate Officers and Directors: Indemnification and Insurance;* Baum & Byrne, *The Job Nobody Wants: Outside Directors Find that the Risks and Hassles Just Aren't Worth It*, Bus. Wk., Sept. 8, 1986, at 56. It is a legitimate legislative concern that it is difficult for corporations to recruit and retain highly qualified individuals to serve as directors — particularly outside directors. The Control Share Chapter provides to shareholders the positive benefits of a control share acquisitions charter amendment without action by the directors that might be challenged as a breach of fiduciary duty. Similarly, the Control Share Chapter addresses the concern that the *absence* of employing defensive tactics in response to a hostile takeover might constitute a breach of fiduciary duty if it turns out that the terms of the offer were not in the best interests of the corporation or the shareholders. *See* Wander & LeCoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 Bus. Lawyer 29, 49 (1986).

The benefits of the Control Share Chapter as understood by *amici* and the absence of such benefits in the view of the Seventh Circuit reveal the disparity of views on this subject. The magnitude of legal and business articles on the subject indicates that there is widely-held disagreement with respect to the benefits and burdens of takeovers.[10] As one commentator has put it, "[t]he debate has not gone on long enough for definitive solutions to a problem we are only beginning to understand. The empiric data is inadequate, and most important, there is no consensus on the goals we are trying to reach." Subak, *Takeovers: Where Are We? Where Do We Go?*, 41 Bus. Lawyer 1255, 1256 (August 1986). Into this climate of confusion and raging debate, the Seventh Circuit has attempted to inject certainty by simply

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[10] *Compare* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161 (1981) (no resistance to tender offers by incumbent management can be justified), *with* Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Colum. L. Rev. 249 (1983) (the advantages possessed by tender offerors under the current regulatory environment justify at least some obstructive tactics on the part of the incumbent board), *and* Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 Harv. L. Rev. 1693 (1985) (neither unrestrained tender offers nor defensive tactics by management serve the best interests of corporate shareholders). *Compare* Ginsburg & Robinson, *The Case Against Federal Intervention in the Market for Corporate Control*, Brookings Review (Winter/Spring 1986) at 9 (the theory that the threat of tender offers forces management into a short-sighted strategy of maximizing current profits is incorrect), *with* Scherer, *Takeovers: Present and Future Dangers*, Brookings Review (Winter/Spring 1986) at 15 (takeovers have not resulted in improved post-takeover performance by acquired corporations). *Compare* Melloan, *New Debate Over Corporate Governance*, Wall St. J., Nov. 11, 1986, at 32, col. 3 (quoting those who argue that the threat of hostile tender offers makes incumbent management more responsive to the rights of shareholders), *with* Melloan, *The Backlash Against Corporate Raiders*, Wall St. J., Nov. 12, 1986, at 32, col. 3 (quoting a chief executive officer who argues that market competition forces efficient management and that the threat of hostile tender offers encourages excessive leveraging of assets).

saying that one argument is right and all the others are wrong.

In the absence of a resolution of the many issues surrounding tender offers by federal legislation, and in the absence of any evidence as to the benefits and the burdens of the Control Share Chapter, the presumption that state statutes in areas traditionally and properly regulated by the states are constitutional should be respected. *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 524 (1959) ("If there are alternative ways of solving a problem, we do not sit to determine which of them is best suited to achieve a valid state objective. Policy decisions are for the state legislature, absent federal entry into the field"). Deferring to the policy decision of the State of Indiana would also promote one of the benefits of federalism — that states may act as laboratories for competing theories about governing. *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting); Ginsburg & Robinson, *The Case Against Federal Intervention in the Market for Corporate Control*, Brookings Review (Winter/Spring 1986) at 9, 14. Of course, the Commerce Clause is not subservient to this "laboratory" philosophy. However, when there is a genuine issue, as a matter of economic theory, as to whether legitimate state interests are furthered or hindered by a statute, the "laboratory" approach is appropriate.

In the final analysis, the State's policy decision will be tested in the marketplace. If the Control Share Chapter truly has the effect of decreasing shareholder wealth, in our free society shareholders will presumably be moved to invest in corporations chartered in states with different corporate laws. The market value of shares in publicly held Indiana corporations will decline, and growing Indiana businesses will have trouble going public. In short, if the Seventh Circuit's economic theory is correct and the Control Share Chapter operates in practice the way the Seventh Circuit speculated it would, Indiana businesses in general will pay the price. The *amici* do not share the Seventh Circuit's economic theory.

### B. The Control Share Chapter is Far Less Burdensome to Tender Offerors Than the Seventh Circuit Believed.

The Seventh Circuit held that a state statute that effectively eliminates the possibility of tender offers succeeding, or of even being launched, is in mortal conflict with the Commerce Clause. The *amici* believe that a review of the actual operation of the Control Share Chapter will demonstrate that it does not set up a "gauntlet" that is incapable of being run.

Under the Control Share Chapter, if the shares acquired in a control share acquisition will put the acquiring person (a tender offeror or any other type of acquiror) over one of the three percentage control thresholds, the acquired shares will not have voting rights unless the shareholders of the target corporation approve a resolution reinstating voting rights for such shares. The issue of voting rights for the acquired shares will be determined at the next special or annual meeting of shareholders unless the acquiring person submits an acquiring person statement, in which case, if requested, the issue will be presented to a special meeting of the shareholders within 50 days of the request.

Several strategies for effectively conducting a tender offer for control, consistent with the Control Share Chapter, are evident. One option is simply to make a tender offer in compliance with the Williams Act for the number of shares the tender offeror desires to acquire, buy the shares, file an acquiring person statement, and begin a campaign to convince a majority of the shareholders to vote in favor of voting rights for the acquired shares. Nothing in the Control Share Chapter prohibits communicating with the shareholders prior to the vote. If unsuccessful in the shareholders' vote, the tender offeror will still own the acquired shares and will have all the rights with respect thereto, except voting rights. Furthermore, the tender offeror can sell his non-voting shares to one or more buyers, with full voting rights, provided no buyer exceeds a control threshold as a result of such purchase.

A more cautious option for the tender offeror would be to submit an acquiring person statement without launching a tender offer. After the date is set for the special shareholders' meeting, the tender offeror could solicit proxies to be used in voting on the voting rights issue or communicate in some other way with the shareholders. If the tender offeror wins the shareholder vote 50 days (or less) later, he can launch the tender offer.

Probably the option most likely to be used is for the tender offeror to simply launch a conditional tender offer. The terms of the tender offer would be that the tender offeror would purchase all tendered shares (up to the limit set forth in the offer), but only if a majority of the shareholders ultimately vote to reinstate the voting rights of the acquired shares. *See MacFadden Holdings, Inc. v. JB Acquisition Corp.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,939 (2nd Cir. October 6, 1986) (holding that shares can be tendered pursuant to a tender offer conditioned upon certain regulatory approvals). The tender offeror's chances of winning the vote would be substantial, because those who have tendered their shares would have a financial interest in voting in favor of voting rights in the absence of an intervening higher offer. The tender offeror could further enhance his chances by soliciting proxies to be used at the special shareholders' meeting or by communicating in some other way with the shareholders. Obviously, if the tender offeror loses the shareholder vote, he loses the expenses of the tender offer, just as any unsuccessful tender offeror would, but he avoids becoming a substantial shareholder without commensurate voting rights.

## CONCLUSION

Because the Control Share Chapter is not concerned with the buying and selling of shares in tender offers and is in the nature of a shareholder rights provision operative only *after* a control share acquisition, it is not preempted by the Williams Act. The *amici* believe the Control Share Chapter provides substantial benefits to Indiana constituencies with very little burden on tender offerors. The intense disagreement among those who have analyzed the issues in the tender offer debate should be resolved by the presumption of constitutionality of state statutes of this type, in the absence of evidence in this case and in the absence of action by Congress. The Seventh Circuit's holding that the Control Share Chapter is unconstitutional by virtue of the Supremacy Clause and the Commerce Clause should be reversed.

Respectfully submitted,

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